Review Article

Determinants of Private Investment: A Systematic Review

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Abstract: Investment is considered as a crucial element of economic growth and post 2015 development agendas. The main aim of this study is to assess the determinants of private investment. For this purpose, concentrated and careful literature review was done on 11 papers conducted in nine African countries. Eight variables were considered for analysis. The result shows that output/national income, public investment and exchange rate are the critical variables affecting the performance of private investment. The others variables: interest rate, credit, inflation rate, international trade, and money supply are also slightly important in explaining the performance of private investment. The study finally recommends that countries should seriously work in creating enabling environment for private investment.

Keywords: Determinants, Private Investment, Economic Growth

1. Introduction

Economic literatures prove that investment is, both empirically and theoretically, the key determinant to economic growth. Economic growth refers to an increase in a country's production or income per capita. It is usually measured by gross national product (GNP) or gross national income (GNI), used interchangeably, an economy's total output of goods and services. Investment is the source of manufactured goods that will be used to produce other goods. It is the major foundation of enhancement in the level of literacy, improvement in technology and increase in the capital stock (Hashmi et al 2012).

A rate of investment is one of the key factors that differentiate developed countries from developing countries. In high-growth countries investment is high, where as it is low in low growth countries. The implication of low investment is that the productive capacity of the economy fails to increase. This in turn leads to lower rates of growth and job creation, and fewer opportunities for the poor to improve their livelihoods (White, 2005). As of Sackey (2007) countries with high standards of living are those who have shifted the economic structure from traditional and less diversified to a more diversified one. Commitment to investment is the central issue in the process of structural diversification.

For developing countries like Ethiopia the basic question in

their economy is increase the production and hence improve the standard of living of their people so that there will be dramatic change in their economic, political and social conditions. For this purpose different alternatives are on the table. Investment promotion is one key instrument and primary engine of economic growth (Mustefa, 2014). As a result due attention has been given to development of private sector in developing countries to help improve economic growth (Ouattara, 2004). Reliable and continuous increase in domestic private investment also helps in reduction of poverty.

Understanding the status and determinants of private investment is essential for successful and effective implementation of sustainable development goals (SDGs). According UN World Investment Report (UN, 2014b) SDGs will require huge levels of both public and private investment in all countries. Even if public finances are considered as central to investment in SDGs, they cannot meet all SDG-implied resource demands. So far, various studies were conducted to identify the determinants of private investment. In view of that, the primary aim of this systematic review is to investigate the main factors affecting private investment in developing countries, particularly Africa. This review may helpful in providing relevant information about policy options for concerning body such as government, policy makers, and other institutions working to improve private investment.

2. Conceptual Framework

Figure 1. Conceptual Framework.

Private investment is a major driver of economic growth. In LDCs, increasing the growth rate of private investment would be a desirable target to achieve post 2015 development agenda. For this purpose policymakers need to find the right balance between creating a climate conducive to investment and removing barriers to investment. They need to find mechanisms to attract private investors (UN, 2014a and UN, 2014b).

It is important to examine the main determinants of private investment. Based on the literature review, this study has

identified both dependent and independent variables. It is expected that dependent variable is affected by multiple factors like economic, social, political, institutional, cultural, geographical and etc. This study, however, focuses on macroeconomic factors affecting private investment.

3. Methodology of the Study

In order to get all the necessary information on the area under which the research is conducted systematic review was used. As regard to sampling, random sampling was used to enhance the representatives of sample. The criteria of selection were relevance of the topic and geographical area of studies. In this procedure, first geographical area and then studies were selected. The variables for this study, dependent and independent, were collected from eleven (11) studies conducted in nine (9) Sub Sahara African countries. The review mainly focuses on the variables affecting long run private investment. Indeed, the majority of them are also the determinants of investment in the short run. The study used descriptive statistical tool (percentage), to differentiate the most influential variables.

Table 1. Studies Selected for Review.

S.N	Author/s	Country	Title
1	Adugna (2013)	Ethiopia	Determinants of Private Investment in Ethiopia
2	Agu (2015)	Nigeria	Determinants of Private Investment in Nigeria: An Econometric Analysis
3	Augustine (2014)	Ghana	Determinants of Private Sector Investment in Ghana, 1970-2011
4	Hailu & Debele (2015)	Ethiopia	The Effect of Monetary Policy on the Private Sector Investment in Ethiopia: ARDL Co-Integration Approach
5	Jalloh (2002)	Sierra Leone	An analysis of the macroeconomic determinants of Private investment in Sierra Leone
6	Kaputo (2011)	Zambia	Macroeconomic Policy And Domestic Private Investment: The Case Of Zambia, 1980 -2008
7	Mbaye (2014)	Kenya	Determinants of Domestic Private Investments In Kenya
8	Assa & Abdi (2012)	Malawi	Selected Macroeconomic Variables Affecting Private Investment in Malawi
9	Molabo & Damane (2015)	Lesotho	Determinants of Private Investment in Lesotho
10	Naa-Idar et al (2012)	Ghana	A Time Series Analysis of Determinants of Private Investment in Ghana (1960-2010)
11	Ouattara (2004)	Senegal	Modelling the Long Run Determinants of Private Investment in Senegal

Source: Reviewed literatures (2015)

4. Results and Discussions

4.1. Description of Reviewed Literatures

This topic describes some of the general characteristics of literatures in terms of country, nature of data, periods under study and models for analysis.

Table 2. Characteristics of Reviewed Studies.

S.N	Author/s	Country	Nature of Data	Time	Models
1	Adugna (2013)	Ethiopia	Time Series	1981-2010	OLS Co-integration-ECM
2	Agu (2015)	Nigeria	Time series	1970–2012	OLS Co-integration-ECM
3	Augustine (2014)	Ghana	Time series	1970-2011	ADRL
4	Hailu & Debele (2015)	Ethiopia	Time series	1975-2011	ARDL Co-Integration
5	Jalloh (2002)	Sierra Leone	Time series	1966-1998	Co-Integration ECM
6	Kaputo (2011)	Zambia	Time series	1980-2008	Co-Integration ECM
7	Mbaye (2014)	Kenya	Time series	1970-2010	OLSECM
8	Assa & Abdi (2012)	Malawi	Time series	1979-2009	Co-Integration ECM
9	Molapo & Damane (2015)	Lesotho	Time series	1982-2013	ADRL
10	Naa-Idar et al (2012)	Ghana	Time series	1960-2010	Co-Integration ECM
11	Ouattara (2004)	Senegal	Time series	1970-2000	ARDL Co-Integration

Source: Reviewed literatures (2015)

The above table shows that all studies are conducted in Sub Sahara Africa between Years 2000 to 2015. Out of the total studies, 9(81.8%) of them were conducted in the second decade of 21st century. Therefore, they provide us the recent phenomena of private investment in Africa. All of the studies used time series data for their analysis and applied an appropriate econometrics models.

4.2. Determinants of Private Investment

Investment, as we have seen earlier, is an engine for economic growth and is one of the most important weapons in poverty alleviation. It improves the productive capacity of the

nation and also creates job opportunity for many people. One of the most important components of investment is private investment in which business institutions engage in the production of goods and services with the twin objectives of profit maximization and improving national economy. That is why due attention has been given to private investment. Different factors are expected to affect the performance of private investment, especially in the long run. In this study, however, eight influential variables are selected from literatures as of the following table. The sign (✓) shows that the variables have been found significant in the long run from reviewed literatures.

Table 3. Long Run Determinants of Private Investment.

S.N	Author/s	Independent variables(all are significant)							
		GDP	ER	PUI	INF	CR	IR	TR	BM
1	Adugna (2013)	✓		✓					
2	Agu (2015)						✓		
3	Augustine (2014)	✓	✓						
4	Hailu & Debele (2015)	✓	✓	✓					✓
5	Jalloh (2002)	✓	✓	✓	✓		✓		
6	Kaputo (2011)	✓	✓	✓	✓	✓	✓		
7	Mbaye (2014)	✓	✓			✓			✓
8	Assa & Abdi (2012)	✓	✓						
9	Molapo & Damane (2015)	✓		✓	✓				
10	Naa-Idar et al (2012)	✓	✓	✓	✓			✓	
11	Ouattara (2004)	✓		✓		✓		✓	
Summary		10/11	7/11	7/11	4/11	3/11	3/11	2/11	2/11
Key: GDP-GDP/real output/income/GDP per-capita PUI-Public Investment ER-Exchange Rate/Real Exchange rate INF-Inflation CR-Credit IR-Interest rate BM- Broad Money TR-Foreign Trade									

Source: Reviewed literatures (2015)

According to Table 3, the main factors affecting the performance of private investment are GDP (national output, national income, GDP per capita) (90.9%), public investment (63.6%) and exchange rate (63.6%). They are found significant in the majority of the studies. The others variables: inflation rate (36.3%), credit (27.2%), interest rate (27.2%), international trade (18.1%), and broad money (18.1%) are also slightly important in explaining the performance of private investment.

Now let us discuss the impacts of change in independent variables on dependent variable (private investment).

Gross Domestic product: GDP is one of the most influential variables affecting private investment. GDP/real GDP/Economic growth/Real Income are positively contributes for private investment development. As of Augustine (2014) and Assa and Abdi (2012), GDP contributes to promotion of private investment. The GDP shows an increase in sales and profits. This would enhance private investment expansion in the economy. According to Basha and Debela (2015), Jalloh (2002), kaputo (2011), Ouattara (2004), Molapo and Damane (2015) and Mbaye (2014), private investment is positively and significantly affected by real GDP/income. Adugna (2013) also identified that real GDP per capita positively affects private investment. The higher real GDP per capita is assumed increase effective demands for goods and services and thereby inspire private

investors. Therefore, in all studies, national output or income positive stimulates private investment.

Public Investment: Public Investment expenditure is also another influential variable that determines affecting private investment. The role of public investment is seen from two aspects. On one hand public investment, in the form basic infrastructures, is a complement to private investment and hence promote private sector expansion and development. On the other hand, public expenditure is a competent of private sector and hence, reduces the amount of money available for them. As of Adugna (2013), Hailu and Debele (2015), Jalloh (2002), Ouattara (2004), and Molapo and Damane (2015), Public investment expenditure directly contributes for private investment. According to them public extensive investments on basic infrastructures-such as roads, energy and telecommunication - creates conducive environment for investment.

However, Naa-Idar et al (2012) and Kaputo (2011), in Ghana and Zambia respectively, found the results that support the theory of “crowding out effect”. According to them public investment is inversely related with private investment. This shows that there is competition for resources between the public and the private sector.

Exchange Rate: Exchange rate, like GDP and public investment, is important in the promotion of private investment. According to Augustine (2014), exchange rate is

positively related to private investment. In the same way, Assa and Abdi (2012) and Mbaye (2014) stated that real exchange rate is positively associated with private investment. According to them devaluation of the exchange rate is costly. It might cause the cost of imported capital to increase. Thus appreciation of the real exchange is beneficial for private sector in this regard. On the other side Hailu and Debele (2015), Naa-Idar et al (2012) and Kaputo (2011) found that exchange rate is inversely related with private investment in Ethiopia, Ghana and Zambia respectively. Jalloh (2002), in the same manner, identified that real exchange rate negatively affects private investment in Sierra Leone. This is because, appreciation of the local currency makes private sectors products less competent in the international market.

Inflation: Except in Ghana as stated by Naa-Idar et al (2012), inflation reduces private investment. According to Jalloh (2002), Molapo and Damane (2015) and Kaputo (2011), inflation plays a contrary role in private investment promotion in Sierra Leone, Zambia and Lesotho, respectively. Inflation causes low levels of private investment since domestic investors foresee a low return on capital.

Interest rate: According to Economists interest is the cost of investment. The results from the studies show that interest rate is inversely related private sector performance in Sierra Leone and Zambia. According to Jalloh (2002), an increase in the real rate of interest will raise the user cost of capital, thereby making investment less profitable. As of Kaputo (2011) real lending interest rate has a significant negative effect in the long-run. This is so because the high cost of investment capital discourages investment by local firms. On the other hand, Agu (2015) found that real rate of return on bank deposits has a statistically significant positive effect on investment behavior in Nigeria. Reasonable level of interest rise saving and hence investment.

Credit: In two out of three cases, credit to private investment negatively affects private sector performance. As of Ouattara (2004), credit to the private sector is negatively related to private investment. This implies that increases in credit to the private sector will not enhance private investment. Weak institutional environment and lack of experienced personnel and expertise were few reasons. In support of above evidence, Mbaye (2014) stated that funds to the private sector do not go to finance new investments because of poverty most people would borrow to finance other matters like education, healthcare and basic necessities. As a result private sector credit is negatively related to private investments. Kaputo (2011), however, suggested that credit plays a significant role in improving private investment.

International Trade: as regard to international trade two issues were considered: terms of trade and trade openness. Ouattara (2004) pointed that the impact of the terms of trade on private investment is negative. Private investment in Senegal is highly sensitive to external shocks. Naa-Idar et al (2012), on the other hand, indicated that trade liberalization plays a positive role in boosting private investment.

Broad Money: The relationship between broad money expansion and private investment is found positive. Hailu and

Debele (2015), in Ethiopia, got that broad money supply is statistically significant. Enterprises and industries are subject to liquidity constraints as a result they are more dependent on bank loans and on short-term debt. Mbaye (2014), in the same token, identified that broad money supply is positively related to private investment and has a significant effect on private investments.

5. Conclusion and Recommendations

Investment is one of the key elements in economic growth and hence improving living standards of nations. A rate of investment is one of the key factors that differentiate developed countries from developing countries. Low investment leads to lower rates of growth and job creation, and fewer opportunities for the poor to improve their livelihoods. The primary objective of this study was to systematically review factors affecting private investment. For this purpose eleven studies were collected from nine African countries. The result shows that output/national income, public investment and exchange rate are the critical variables affecting the performance of private investment. The higher real GDP per capita is assumed increase effective demands for goods and services and thereby inspire private investors. Public investment, in majority of the case, is seen a complement to private investment and hence promote private sector expansion and development. Exchange rate, like GDP and public investment, is important in the promotion of private investment. However, countries should take care in its management as its implication is in both directions: positive and negative.

The others variables: interest rate, credit, inflation rate, international trade, and money supply are also slightly important in explaining the performance of private investment. In this regard, reasonable interest rate, broad money expansion and trade liberalization positively contributes to private investment. On the other hand, inflation and mis-targeted credit reduces private investment. Because of poverty, people, sometimes, would borrow to finance other matters like education, healthcare and basic necessities. The study finally recommends that countries should seriously work in creating enabling environment for private investment. To promote private sector investment, countries needs to improve real income of people; maintain macroeconomic stability and make public investment in basic infrastructures and institutions that are fundamental to promote private investment.

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